

RESEARCH



ABERDEEN

OFFICE MARKET ACTIVITY REPORT
SPRING 2016



HIGHLIGHTS IN 2015

Office take-up falls by 61%
to 401,000 sq ft in 2015

Supply reaches a record
level of 1.8m sq ft

Investment volumes
drop by 82% from 2014

Occupier incentives
at record levels

ECONOMIC OVERVIEW

For 2016, the consensus forecast is for UK GDP to grow by 2.2%, which is in line with the 2015 figure.

This represents a healthy level of projected growth, and is better than that expected for most other G7 nations this year, with the exception of the US. However, downside risks are elevated for two main reasons.

Firstly, June 2016 will see the UK's EU 'in/out' referendum. We believe economic growth will decelerate in the run-up to the poll, as firms take a wait-and-see approach. If there is a vote to leave, our expectation is for business activity to remain subdued while new trade treaties are negotiated.

Secondly, the UK faces headwinds from the global economy, which are particularly acute for the energy sector; the driving force behind Aberdeen's economy. Brent crude oil is currently trading in the mid-\$30s a barrel, down from over \$100 in mid-2014. Figures from the International Energy Agency show global oil production exceeding demand by 1.4 million barrels per day. Inevitably this has led to job losses in the North Sea.

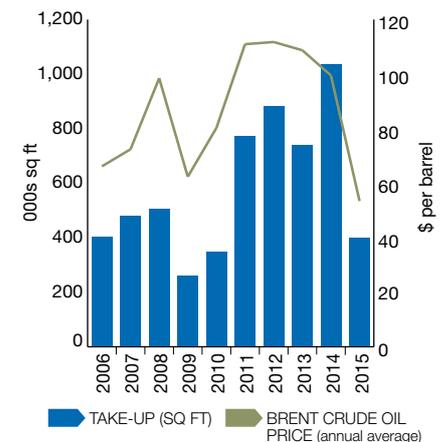
Given the high level of supply, we see little reason to expect a short-term rebound for oil prices, which has already impacted on Aberdeen's local economy. In the long-run, cheap energy should support global economic growth, leading to increased demand for oil over the long-term.

Moreover, in contrast to last autumn when there was growing speculation that UK

interest rates might rise in 2016 – a move which would have been badly timed for Aberdeen's economy – most City analysts are now forecasting no change for this year. The very low rate of inflation at present supports that view, which should help firms and consumers at a time when the pressure to control costs is high.

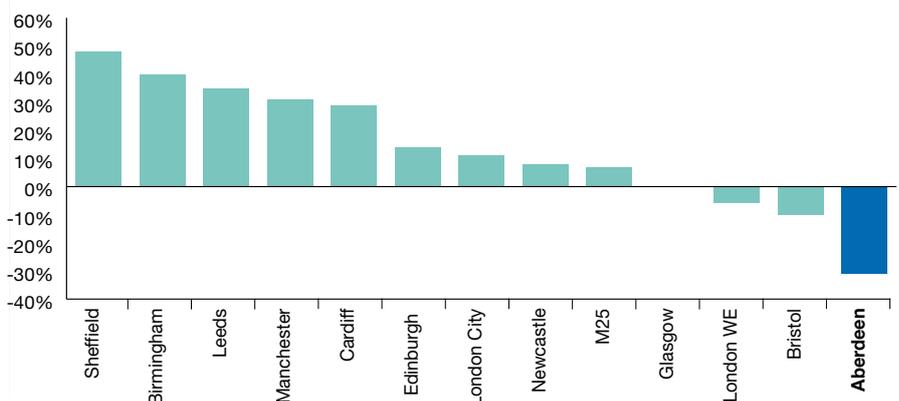
Consequently, our outlook for the Aberdeen economy is cautious for the short-term, but more optimistic for the medium-term as ultimately the oil price will move into a new cycle.

FIGURE 1
Aberdeen office take-up and oil prices



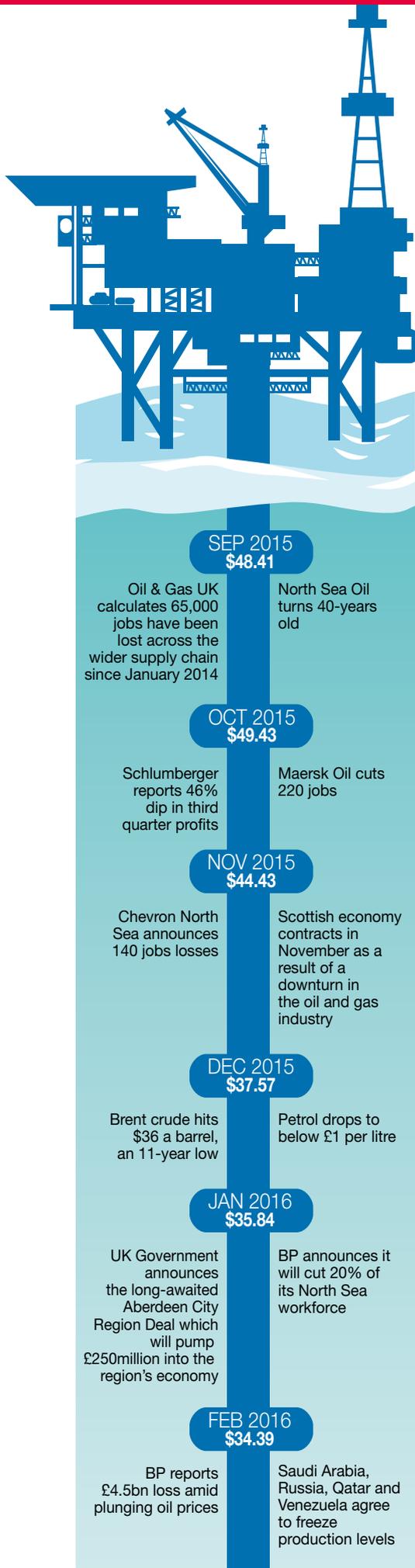
Source: Knight Frank Research / Thomson Reuters

FIGURE 2
2015 take-up vs 10 year average



Source: Knight Frank Research

Aberdeen 10-year average: 583,500 sq ft



Source: Knight Frank Research
Spot price 1st of each month

OCCUPIER MARKET

What a difference a year makes...

Following the unprecedented market of 2014, volatility in the oil sector in 2015 had a significant impact on market conditions in Aberdeen. A total of 401,000 sq ft of office space was transacted during the year, 61% less than in 2014.

The collapse in oil prices has been devastating, resulting in major oil occupiers reversing expansionary strategies and retrenching. This has led to a sharp fall in new demand for office space leaving a significant amount of vacant space overhanging the market.

Notably, more than 50% of take-up, and the largest transactions of 2015 were “out of town” pre-lets agreed prior to the fall in oil prices. The largest transaction was the 100,000 sq ft pre-let to LR Synergy at the Prime Four Business Park. This was one of two deals at Prime Four during the year with Anderson, Anderson and Brown taking 45,000 sq ft in Q2. Preceding these was the 70,000 sq ft pre-let to KCA Deutag at City South.

The largest transactions involving existing stock were confined to the city centre. These included Enquest’s sub-let of 42,800 sq ft to AMEC at Annan House. Aberdeen Asset Management also secured their first new tenant at the refurbished AB1 development, with the Oil and Gas Authority (OGA) taking 12,029 sq ft. There were two other transactions in the region of 10,000 sq ft during 2015. These were the leases to MOL Energy at Riverside House and DNV GL at The Exchange. Both completed in the first half of the year.

By the end of 2015, active requirements in the market totalled circa 200,000 sq ft. Of this, over 71% was for space below 5,000 sq ft. Only one requirement was for over 20,000 sq ft.

With demand falling sharply, availability increased to 1.83m sq ft in 2015, the highest recorded level. Significantly, the level of available Grade A space had risen seven-fold to 526,000 sq ft by the end of 2015.

Despite the market slowdown, speculative development has continued in the city centre. The Knight Property Group and M&G’s 73,000 sq ft joint venture ‘The Capitol’ is scheduled to complete in March 2016. This will be followed by Titan/BA Pension Fund’s 132,000 sq ft Silver Fin development at Union Street. Muse’s 170,000 sq ft Marischal Square development is also under construction and will complete in Q2 2017. Significantly, Dandara’s proposed 80,000 sq ft ‘Point development’ has halted with planning permission now obtained for student accommodation. Similarly, the proposed 100,000 sq ft R7 development at Rubislaw Quarry has not been progressed.

Prime rents remained unchanged at £32.00 per sq ft in 2015. Net effective rents, however, have fallen as a result of an increase in incentives. The winners are occupiers who can choose to take advantage of these exceptional market conditions.



TABLE 1
Key office transactions in 2015

Address	Tenant	Size (Sq ft)	Rent (£ per sq ft)
Phase 2, Prime Four Business Park, Kingswells	LR Synergy	100,000	Undisclosed
City South, Portlethen	KCA Deutag	70,000	£21.50
Phase 2, Prime Four Business Park, Kingswells	Anderson, Anderson & Brown	45,000	£28.75
Annan House, Palmerston Road	AMEC Foster Wheeler Group Ltd	42,800	£24.50
AB1, Huntly Street	Oil & Gas Authority	12,029	£26.00
Riverside House, Riverside Drive	MOL Energy UK Ltd	10,578	£24.00
The Exchange, Market Street	DNV GL	9,100	£25.50

Source: Knight Frank Research

KNIGHT FRANK VIEW

- The volatility of the oil price will continue to impact the office market for the remainder of 2016.
- There will be a continued downward pressure on rents in 2016 and incentives will move out further.

INVESTMENT MARKET

The volume of investment transactions deteriorated substantially in 2015, following the collapse in occupier demand.

The slowdown in activity highlighted the level of apprehension in the market, as investors opted to ‘wait and see’ before making any decisions on whether to buy, or indeed sell.

Investment in Aberdeen’s offices reached £90m, an 82% decrease on the previous record year of 2014 and 46% lower than the 10-year average. The last time Aberdeen saw such a lack of investment activity was in 2009, when the city faced the impact of the global financial crisis and the last oil price crash. In 2015, Aberdeen accounted for 10% of investment in Scottish offices, set against a ten-year average of 25%.

The Aberdeen market was effectively dominated by a handful of sales comprising new or refurbished Grade A stock let on long leases to secure covenants. With less competition being witnessed from the mainstream Funds and Institutions which had been extremely active for the previous three years, we saw the market open up to a more diverse range of buyers during 2015.

There were only four transactions above £10m in the Aberdeen office market in 2015, compared to 14 the previous year. The largest transaction of the year was the 20 year sale and leaseback of Annan House by EnQuest which sold to Rockspring for £44.1m reflecting a

yield of 6.36%. Together with developer Dandara’s 20 year forward commitment sale of the KCA Deutag HQ at City South for £23.5m – reflecting a yield of 6.03% – this appeared to confirm that yields have softened 25 to 50 BPS in 2015.

In addition to the listed property transactions, The iQ building on Justice Mill Lane changed hands as part of a three building equity finance transaction. The deal saw Aerium sell the portfolio to Mapletree Investments for close to £365m reflecting a yield of 5.7%. The iQ building is let to Wood Group and Centrica with an unexpired term of 10+ years so again provides further demonstration of the resilience of the Aberdeen market for prime product.

There was however, a notable absence of secondary investment stock being brought to the market. Vendors were fearful of receiving little or no interest as investors monitored the fast-changing occupational market.

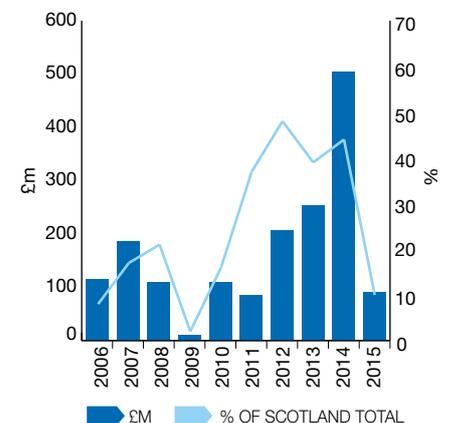
In line with the market as a whole, buying activity for private investors was also limited and selective. With many local investors having close affiliations with the oil and gas market, it was unsurprising to see their interest in Aberdeen ‘cool’ and in some cases divert to the improving central belt markets.

“Investor confidence has been undermined by volatility in the global oil market.”

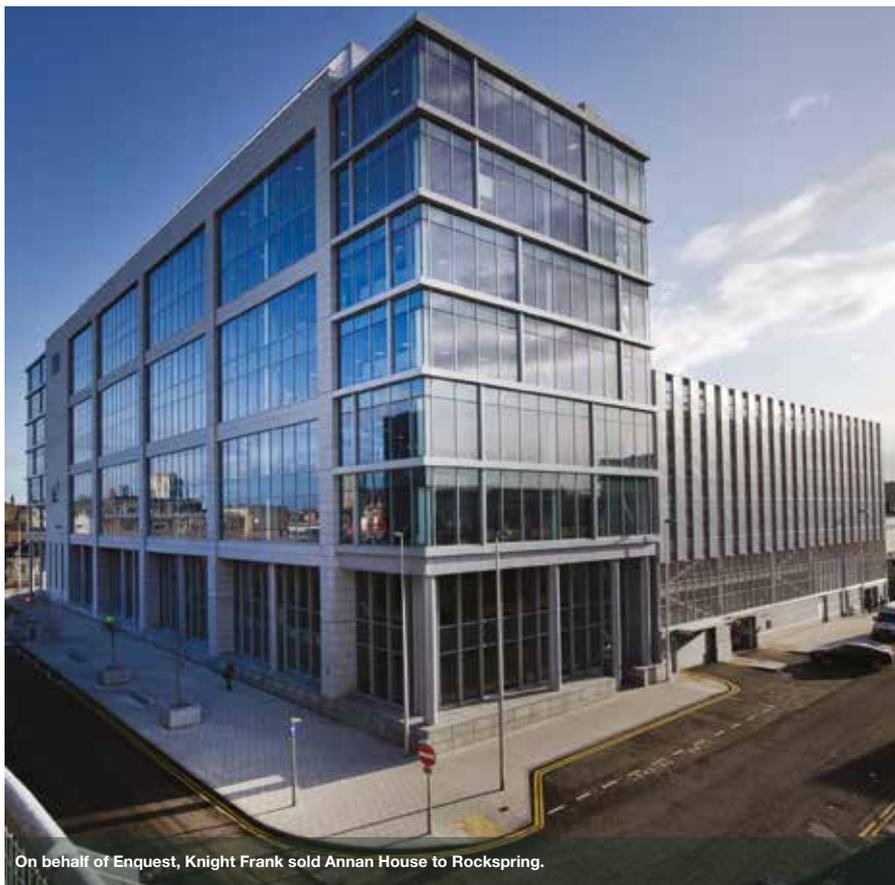


City South, Portlethen – sold by Dandara

FIGURE 3
Aberdeen offices investment volumes



Source: Knight Frank Research/Property Data



On behalf of Enquest, Knight Frank sold Annan House to Rockspring.

“Yields will move out on all stock to varying degrees, although movement will be difficult to prove due to lack of transactions.”

TABLE 2
Key office investment transactions in 2015

Address	Size (Sq ft)	Price (£m)	Net initial yield (%)	Purchaser
Annan House, Palmerston Road	120,821	£44.10	6.36%	Rockspring
KCA Deutag, City South, Portlethen	70,000	£23.50	6.03%	Private Family Trust
6 Queens Road & 31-33 Union Grove	23,294	£10.88	5.88%	Beauchamp Investments
Peregrine House, Peregrine Road, Westhill	31,314	£10.20	6.24%	Capital Trust Group

Source: Knight Frank Research

KNIGHT FRANK VIEW

- Given the current supply in the occupational market we envisage very limited long income buying opportunities. Those that do become available should see reasonable demand as Aberdeen offers perceived value compared to other regional cities.
- As the market re-adjusts and money is required to be recycled we expect to see more secondary opportunities come to the fore.
- As values are written down, we would expect some assets to be bought for future redevelopment.

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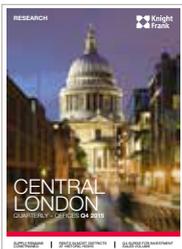
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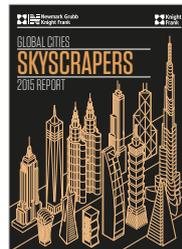
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